

Transposing UCITS IV into UK Law

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On 22 December 2010, the Financial Services Authority (FSA) and HM Treasury published a joint consultation paper¹ (Consultation Paper) on the UK implementation of UCITS² IV. UCITS IV repeals all current UCITS directives and must be implemented into national law by the UK and all other Member States by 1 July 2011.

UCITS IV presents a range of opportunities for UCITS fund managers. These include a simplification of the processes required to market UCITS funds on a cross-border basis within the EU and an ability to manage UCITS funds from other Member States. There are also new rules for a much simplified investor disclosure document (in place of the existing simplified prospectus), an ability to designate certain UCITS funds as feeder funds that invest the majority of their assets into a master UCITS fund, and a new mechanism enabling a UCITS fund manager to merge UCITS funds together. All these changes should result in greater efficiencies for the EU cross-border fund management industry.

This article assesses some of the key amendments, together with the statutory and regulatory changes that have been proposed to implement UCITS IV in the UK.

UCITS Directive

The objectives of the original UCITS directive³ were 1) the creation of investment opportunities for EU fund investors and 2) business opportunities for the EU fund industry – both of which were to be achieved through the integration of EU markets for mutual funds. Nonetheless, despite various proposals and amending directives (principally those known as UCITS III) the UCITS regime still did not provide an effective harmonised European market for mutual funds and in 2009 the European Commission proposed that a single new directive⁴ should come into force to replace and supplement all the existing UCITS directives – UCITS IV.

UK Implementation Proposals

The FSA and HM Treasury intend to implement UCITS IV through amendments to regulation and to the FSA Handbook. In the Consultation Paper, drafts of the following documents were published:

- The Undertakings for Collective Investment in Transferable Securities Regulations 2011 (UCITS Regulations).⁵ These draft regulations include material on implementing UCITS IV's requirements on mergers and amendments to relevant primary legislation, in particular the Financial Services and Markets Act 2000 (FSMA)

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and the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228) (OEIC Regulations).

- UCITS Directive Instrument 2011 (UCITS Instrument).⁶ This draft instrument sets out amendments to the FSA Handbook and, in particular, the Collective Investment Schemes sourcebook (COLL), the Conduct of Business sourcebook (COBS) and the Supervision manual (SUP).

The key areas of the Consultation relevant to managers managing UK or non-UK UCITS funds are set out below.

Simplified Notification Procedure

The FSA has transposed most of UCITS IV's requirements, with respect to a management company seeking to market a UK UCITS fund in another Member State, into COLL.⁷ Specifically, COLL 12.4.4R and 12.4.8R will cover the duties of the authorised fund manager (AFM) to ensure that regulators in the host Member States where the UCITS fund is to be marketed are sent up-to-date versions of scheme documents and given notice of any changes to marketing arrangements. The FSA expects to publish additional information on its website explaining the procedure for submitting a notification letter.

Management Company Passport

UCITS IV introduces a management company passport that allows an AFM established in one Member State to operate a UCITS fund established in another Member State. This passport can be exercised by an AFM either by providing cross-border services or through establishing a branch in the UCITS' home Member State. The new passport applies specifically to "collective portfolio management." It does not affect the existing right of AFMs to offer individual portfolio management and other services, where authorised to do so by the regulator of their home Member State.⁸ To

ensure the smooth functioning of the passport, including the mutual recognition of authorisation and supervision, and to provide investors with greater certainty about standards of protection, UCITS IV therefore harmonises the rules pertaining to AFMs' organisational requirements, conflicts of interest procedures, conduct of business, and risk management.

Handbook Amendments

To implement the changes required by UCITS IV, HM Treasury will make consequential amendments to FSMA, and the FSA will amend COLL, COBS, SUP and the Senior Management Arrangements, Systems and Controls Sourcebook (SYSC), as well as amending the passporting notification forms. In the context of delegation or sub-delegation, it is important to note that the new rule in SUP 15.8.6R will require AFMs to provide the FSA with prior notice of any intended delegation before it takes place, rather than the post-delegation notice required by the current rule.

Key Investor Information Document (KIID)

UCITS IV requires that the KIID must replace the existing UCITS simplified prospectus. The KIID is intended to be a shorter, more concise form of disclosure that contains only the essential information for investors to make their investment decisions, and sets this information out in a clear and accessible manner. It must be a single document of limited length, identify the strategy of a UCITS fund and include a short description of its investment objectives and policy, past performance, charges, and its risk/reward profile. The FSA will transpose most of the UCITS IV requirements relating to the KIID into COLL,⁹ with the relevant conduct of business rules relating to provision of the KIID by a management company, both when selling directly and when providing text or copies of the KIID for distribution by other intermediaries, being implemented in COBS.¹⁰

Master-feeder Structures

The UCITS directives place strict limits on the amount of a UCITS' assets that it can invest in another fund. However, UCITS IV permits a UCITS fund (called a "feeder" fund) to invest the majority of its assets into another single fund¹¹ (called a "master" fund), in what is referred to as a master-feeder structure. UCITS operators wishing to establish a master-feeder arrangement can be established in the same Member State or different Member States, but both the master and feeder funds must be subject to UCITS IV. The master UCITS fund cannot itself be a feeder, nor can it hold units in any other feeder UCITS fund. A master UCITS may accept investment from the general public, or may restrict its investors to feeder funds – in which case it must have at least two feeder UCITS funds. There is no restriction on a master UCITS fund accepting investment from non-UCITS feeders. The feeder fund must have its investment in the master UCITS fund approved by its home Member State regulator. The regulator must grant the feeder UCITS fund authorisation if all the conditions set forth in UCITS IV are met, and must inform it as to whether or not the investment in the master UCITS fund has been approved within 15 working days of receiving a complete application. HM Treasury is proposing to make statutory changes to FSMA and the OEIC Regulations to implement the relevant elements of UCITS IV, and the FSA will make changes to COLL, principally in COLL 11.

Mergers

UCITS IV introduces a harmonised EU framework for the mergers of UCITS funds. The rules apply to all UCITS funds, irrespective of their legal form (e.g., unit trusts, investment companies or contractual funds).

Each Member State is required by UCITS IV to recognise cross-border mergers between all types of UCITS funds, but they do not need to provide for new legal forms of UCITS funds in national law. All mergers covered by UCITS IV must be subject to prior authorisation by the regulator of the merging UCITS funds (the UCITS fund that will cease to exist

post-merger), and UCITS IV sets forth the procedure for seeking such authorisation, including the content of the information that must be provided by the merging UCITS fund to its regulator. Each regulator will then assess, and may demand amendments to, the information to be provided prior to the merger to the investors of the UCITS fund that it regulates. HM Treasury proposes to bring the merger requirements into UK law through amendments to the UCITS regulations, with the FSA making amendments to COLL 7, adding a new COLL 7.7.

There are no proposals to change the UK regulatory regime or the FSA rules in connection with other types of UK-authorized funds. However, the FSA is considering what changes might be appropriate to make to the regime for non-UCITS retail schemes (or "NURS") consistent with UCITS IV. It aims to consult on any changes relating to non-UCITS UK-authorized funds in the next three months, although it does not expect rules to be in place before 1 July 2011.

Timing

The consultation was open for comment until 21 March 2011. The FSA and HM Treasury anticipate being in a position to publish their final rules within a few weeks.

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⁷ See new COLL 12.4.

⁸ Such services are subject to rules made under Directive 2004/39/EC on markets in financial instruments (MiFID) together with Directive 2006/73/EC, implementing MiFID.

⁹ See new COLL 4.7.

¹⁰ See COBS 14.

¹¹ In order to ensure that UK firms are able to take advantage of the master-feeder structure, Mark Hoban MP, Financial Secretary to HM Treasury, announced in a speech on 22 November 2010 that the Government intends to launch a new authorised fund regime for a tax transparent vehicle. The Government will continue to develop the details of such a vehicle in consultation with industry, before introducing the new regime in 2012.

¹ Transposition of UCITS IV – HM Treasury & Financial Services Authority Consultation Paper, December 2010.

² Undertakings for Collective Investments in Transferable Securities.

³ Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) OJ L 375, 31.12.1985, p. 3–18.

⁴ Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) OJ L 302, 17.11.2009, p. 32–96.

⁵ *Supra*. note 1 at Annex B.

⁶ *Id.* at Annex C.

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